Testimony of
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INTRODUCTION

Good afternoon to you Madam Chair and the distinguished members of the Acquisition Advisory Panel (AAP).

My name is Mark Stelzner, and I represent EquaTerra Public Sector, a business unit focused exclusively on applying commercial sourcing and advisory best practices to the unique requirements of public entities. My background includes the management of hundreds of vendor relationships for a large commercial outsourcer, consulting to government and quasi-government agencies on workforce effectiveness and personnel, as well as the application of shared services techniques to enhance the mission-orientation of public and private entities alike.

Let me begin by thanking the Panel for their commitment to promoting thought leadership in the award and administration of Federal contracts. Your work will help ensure effective, efficient and fair outcomes in government contracting. These same values underpin the approach my organization, EquaTerra, takes in helping public and private entities maximize operational efficiency gains.

EquaTerra's advisors have led over 700 transformational sourcing engagements for the most complex environments in the world. In the past twelve months alone, we have advised on over $10 Billion in total contract value. In the commercial sector,

one out of every two business process outsourcing (BPO) engagements in the world is led by an EquaTerra advisor.

We understand that the public sector has unique requirements which at times are largely unmatched among commercial entities. Today I intend to focus the Panel's attention on three specific commercial best practices that do have direct application to the success or failure of public sector acquisition and sourcing:

1)   First, the deployment of a lifecycle approach to ensure that the cost savings envisioned are truly realized;

2)   Second, applying governance and relationship management as a critical and effective means for value assurance and enhancement; and

3)   Finally, the critical nature of independent, conflict-free advice and guidance as an accelerant to attaining mutually beneficial outcomes

I.   THE LIFECYCLE APPROACH

The panel has heard testimony from numerous experts on the important issue of what I characterize as "the transaction" - namely the means, processes, governing circulars and suggested enhancements to the current mechanism of acquisition for goods and services. Let me suggest that although this is a critical component warranting ongoing investigation, strategic acquisition requires a multi-faceted, lifecycle approach to maximize operational efficiencies and cost savings. This approach has proven time and again to drive significant results in the commercial sector.

This lifecycle is comprised of four main phases:

| Knowledge and Education	Strategy and Assessment	Sourcing	Relationship Management and Governance

Phase I: Knowledge and Education

Phase I of the four-phase lifecycle is knowledge and education. As public entities struggle to simultaneously reduce costs and increase quality, the time pressures for delivering results often reduce emphasis on knowledge capture and education. EquaTerra's experiences demonstrate the need for three critical steps to ensure organizations have the knowledge that is the foundation of any successful initiative:

1) First, the utilization of <u>executive-level peer groups</u> to promote the sharing of relevant information, trends, developments and best practices. These networks typically assemble via forums, conferences, webcasts, and joint research efforts and often involve the collaboration of traditional competitors across similar industries.

2) Second, <u>independent research and analysis</u> should be sanctioned to review, interpret and apply market-leading concepts, industry trends and best practices. This can avoid the costly mistake of acquiring goods or services which may be rapidly commoditized, rendered obsolete or trending downward in further research and development investments.

3) Finally, capturing <u>business intelligence and measurement benchmarks</u> around service delivery alternatives, operational costs, quality and timeliness in both the pre and post-deployment environments.

Phase II: Strategy and Assessment

Provided that the findings captured during the Knowledge and Education phase present a compelling business case for further exploration, Phase II - the Strategy and Assessment phase - begins. This phase includes four specific steps: 1) mobilization and scoping; 2) economic modeling; 3) service provider collaboration; and 4) opportunity case and strategy construction.

Strategy and Assessment	Mobilization and Scoping	Economic Modeling	Service Provider Collaboration	Opportunity Case and Strategy Construction
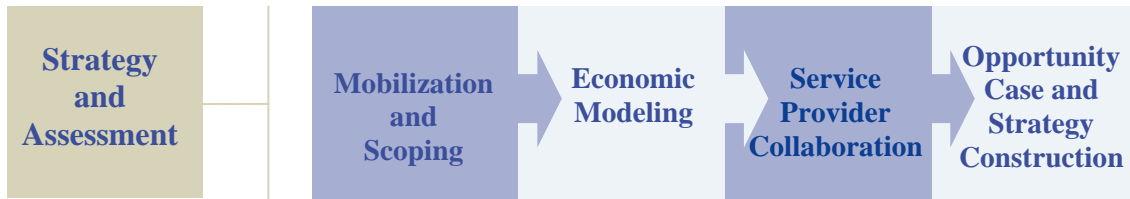
1) Mobilization and Scoping:

➤ Begins with the identification of internal and external stakeholders, the decision process, and criteria for continuation. This early establishment of role clarity can prevent unwanted delays and eliminate potential stalemates down stream;

➤ Develop a strong definition of initial options, parameters and scope. Identifying issues or problems clearly out of scope is at times as important as articulating what is open for consideration;

➤ Identify related projects, ongoing initiatives and previously completed tasks of relevant application. This will eliminate duplication of effort, "shadow" projects and surprises at later stages;

➤ And finally, develop an initial project plan and mobilize a project team which has both ownership and accountability for the timely execution of deliverables.

2) Economic Modeling

Once mobilization and scoping is complete, entities should begin the second step in strategy and assessment by identifying true baseline costs for accurate economic modeling. This is the benchmark against which all future gains will be measured. The public sector can adopt several practices from the private sector to achieve this sometimes daunting task:

➢ Begin by developing or leveraging existing <u>data collection models,</u> templates and processes;

➢ Identify <u>headcounts and costs</u> that can or will be impacted;

➢ Define <u>best practice gaps</u> against benchmark data collected during the knowledge and education phase;

➢ Segment <u>service delivery model alternatives</u> for comparative and projected benefit analysis[1]; and

➢ Define <u>scenarios and sensitivities</u>, including agreed-upon assumptions for validation and evaluation.

3) Service Provider Collaboration

The next step in the strategy and assessment phase is service provider collaboration. This is often where public and private entities alike may issue a Request for Information (RFI)[2]. The desired outcome should be

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[1] Typical service delivery model alternatives include – a) the current trajectory; b) internal process transformation; c) consolidation, economy of scale and/or shared services creation; d) the use of inter or intra-agency service providers; e) public/private partnerships; or f) holistic outsourcing.

[2] EquaTerra's experience shows that an RFI only be issued if – a) the market for the services to be sourced is <u>emergent</u> and the capabilities of potential service providers are unknown and/or rapidly changing; b) the client's procurement organization either controls or is very influential in the process, and thus <u>a policy exists</u> that RFIs should be issued in every case; or c) the client requires a <u>comprehensive market review</u> to socialize the market capacity and the capabilities of potential service providers with key stakeholders, as part of a buy-in process.

early collaboration with the service provider community to attain clarity relative to:

- ➢ Service provider capabilities;

- ➢ Alternative service delivery models not previously contemplated;

- ➢ Market interest in the scope, size and complexity of the opportunity; and

- ➢ Any inherent risks or limitations to proceeding with a sourcing or acquisition strategy.

4) Opportunity Case and Strategy Construction

The final step in this phase is opportunity case and strategy construction. This is where qualitative benefits and risks are summarized, the desired service delivery model strategy is finalized, communication and change management strategies are outlined, the next phase plan is defined, approval to proceed is secured, and resources for sourcing and acquisition are allocated.

Bear in mind that all of this activity precedes any formal procurement mechanism while preserving the sanctity of existing regulatory compliance and acquisition policies.

It is not unusual for commercial entities to reach this point only to realize that a significant economic business case was not achieved and therefore further investment is unwarranted. Typically, commercial organizations must identify anticipated savings of 20% over existing baseline costs for continuation to the Sourcing phase.

Phase III: Sourcing

Phase III of the lifecycle approach is sourcing. In respect for the Panel's time and prior testimony, I will spend little time discussing this portion of the lifecycle. EquaTerra has significant experience in this area and would be happy to discuss our philosophy and approach as desired[3].

II.   RELATIONSHIP MANAGEMENT AND GOVERNANCE

I would now like to turn to perhaps the most vital and often overlooked phase of lifecycle sourcing—relationship management and governance. Several years of research have shown that sourcing relationships with effective governance organizations deliver more value than those that do not[4]. Benchmarking indicates that effective sourcing governance costs between 3% and 10% of the total contract value[5] – but that only tells part of the story. What are the elements that differentiate effective governance from contract or supplier management? And what is the "value add" these elements provide -- or the "value lost" when they are missing?[6]

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[3] EquaTerra's philosophy and core tenets as applied to over 700 sourcing transactions globally includes – a) We believe focus should be placed on viable, long-term relationships; b) Successful and balanced relationships are achieved by being collaborative, enabling convergent behaviors, and encouraging mutual respect; c) All parties should abandon adversarial behaviors; d) our client's best interests are served if we achieve a good, safe, fair and sustainable outcome for both parties; and e) the lifetime success of sourcing agreements is critically dependent on effective relationship management and governance.

[4] "Companies that have created effective vendor management organizations are finding cost savings across the enterprise…up to 15% of the total contract value" Giga, *IT Trends*

[5] Gartner Group, Meta Group, IDC, EquaTerra (collective findings)

[6] Several comments extracted from Cathy Hyatt's article, "Effective Outsourcing Governance". Ms. Hyatt is an EquaTerra advisor with more than 20 years experience in relationship management and governance.

The principles of relationship management and governance are not new, and tend to work best when matched to the complexity of a particular sourcing agreement. Elements of sourcing complexity include the functional scope, geographical scope, the nature of the work to be performed, and the degree of internal organizational and cultural change required to deliver the expected results.

This process combines traditional contract and supplier management processes, such as contract administration and financial oversight, with key elements that have been shown to prevent the "value leakage" common to poorly governed sourcing agreements. EquaTerra recognizes three steps that define good governance – 1) relationship management; 2) service delivery management; and 3) joint planning.

1) Relationship Management

Let me begin with relationship management, which describes the work associated with the continuous alignment of the expectations of all stakeholder groups[7]. Unfortunately, responsibility for relationship management is often assigned as a secondary consideration or overlooked entirely. With so many diverse stakeholders, effective relationship management cannot be delivered as a part-time job.

Complex agreements are especially dependent upon strong relationship management to both adapt to changes unanticipated by the contract and achieve long-term goals. Building sufficient relationship management strength into the governance organization at its inception will help trust to grow. However, it is important to keep in mind that not all relationship managers are created equal. Effectively managing

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[7] At a minimum these stakeholder groups include: the service recipients, the service provider(s), the governance organization, functional units (both sourced and retained), the business unit leaders, and the client company's executives.

the relationship between service users and the service provider requires both commitment and the right people – people with subject matter experience <u>and</u> organizational credibility[8]. Poor relationship management can quickly lead to client dissatisfaction with the service provider. This may grow as new projects and change-orders for services are inadequately specified and ultimately fail to meet the business units' true requirements.

2) Change Management

The next step of good governance is effective change management. Change management in sourcing governance is a bifurcated process, including:

1) Both the adaptation of a static service specification, as documented in a contract, to ever-changing organizational needs; and

2) Changing the organizational culture and internal dynamics sufficiently to obtain the expected results.

While a traditional contract administration group will be capable of adapting a contract to change over time, they may lack the skills and talents needed to manage organizational change. Vision, influence, creative solution development, coaching, strong internal relationships, and a commitment to results and perseverance are needed to fully leverage the capabilities of the supplier and to foster continuous improvement through cultural adaptation.

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[8] A multi-state insurance company that outsourced its entire information technology (IT) organization learned a difficult lesson when they tried to save money by staffing these key roles with very junior business people. While these "Relationship Managers" tried very hard to communicate the benefits of the agreement to their business clients, they were largely ignored. Lacking both IT skills and the credibility that comes with experience, they were unable to translate the agreement into business-meaningful terms their clients could understand. And when their business unit clients asked them to develop new project requirements or a business case for changing the agreement, they were at a loss.

3) Joint Planning

The third and final lesson of good governance is the use of joint planning. Commonly overlooked is the opportunity to conduct joint strategic planning sessions, where the leaders of both the client and provider come together to understand each other's strengths and goals and to build a shared future vision.

Circumstances can change dramatically for agencies involved in transformational or transactional agreements. Divestitures, reorganizations, or mergers and acquisitions affecting your supplier can create the kind of change that throws previous goals into question. A governance organization empowered to develop and implement a shared planning process can go a long way toward maintaining the health of the relationship and to ensuring its ability to achieve the agreement's goals over the longer term. Such a process, however, is an all-too-frequently overlooked aspect of sourcing governance[9].

The Impact

These key elements of effective relationship management and governance can make the difference between a successful sourcing relationship and an expensive failure. EquaTerra's vast experience shows several quantifiable effects which can erode the total potential value gained from the sourcing relationship by more than 50%[10].

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[9] Other key governance elements that are commonly overlooked include: a) the ability to develop and maintain a base case or financial model which describes the expected financial savings over the term of the agreement; and b) performance management capabilities needed to facilitate the continuous improvement of service levels over the term of the agreement.

[10] Value erosion can include: a) Operational Challenges (10-20% value loss due to duplication of effort and wasted resources); b) Performance Challenges (20-30% value loss due to poor problem management and performance below contractual expectations); and c) Portfolio Management Challenges (5-10% value loss due to untapped opportunities and/or vendors deploying against conflicting or inappropriate goals).

By including the key elements of relationship management, change management and joint planning as responsibilities of a governance organization that is matched in size and scope to the complexity and goals of the sourcing agreement and staffed with highly skilled professionals, public agencies can substantially decrease the risks of sourcing while increasing the intended value proposition to the organization at large.

III.   INDEPENDENT, CONFLICT-FREE ADVICE AND GUIDANCE

Finally, I'd like to discuss the importance of independent, conflict-free advice and guidance. In the July 2005 GAO report on Interagency Contracting[11], the GAO assessed whether franchise funds ensured fair and reasonable prices for goods and services, whether DOD analyzed purchasing alternatives, and whether DOD and franchise funds ensured value by defining contract outcomes and overseeing contractor performance.   To paraphrase GAO's findings, it was found that GovWorks and FedSource – two such franchise funds – generally added substantial work and costs, did not ensure fair and reasonable competition, did not conduct price analyses, and at times paid contractors higher prices for services than established in contracts without justification. Furthermore, GAO has designated management of interagency contracting as a government-wide high risk area[12].

To avoid these costs, mitigate risk and ensure that an agency's acquisition of goods and services are beyond reproach, is it highly recommended that independent, conflict-free advisory services be required across federal procurement.

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[11] GAO-05-456
[12] GAO-05-207

Federal entities benefit from acquisition advisory services which:

1) Convey commercial best practices;

2) Accurately capture the motivation and capabilities of potential service providers without fear of collusion or potential protest;

3) Eliminate the common practice of conflicted consultants advising a federal agency on service delivery models; and

4) Are more cost effective than interagency providers. Typical commercial advisory and governance services represent a fractional cost relative to the savings derived.

Sample questions to ask either your interagency provider or existing advisory consultant include:

1) What fee basis have you established for your advisory services?

2) Do you, or your parent, recognize revenue or fees of any type from potential service providers?

3) Do you intend to offer products or system integration services related to the outcome of your advisory engagement?

4) What amount of time does your organization spend assessing commercially viable best practices for application to our needs?

5) What tools, methodologies and approaches will be customized to the unique circumstances of my agency's needs?

As you consider the best methods for sourcing goods and services, do not lose site of the value that private sector advisory firms such as EquaTerra can offer government agencies in executing lifecycle sourcing and effective relationship management and governance. This panel could provide agencies with guidelines to ensure that the advisors they use are truly independent, conflict-free and up to the task.

Measurable process improvement is the most important outcome to be attained, regardless of the service delivery model applied. Whether via internal transformation, shared services creation, the selection of intra-governmental providers (e.g., the HR Lines of Business), or outsourcing, quantifiable benefits are to be gained by applying conflict-free advice and guidance through a lifecycle approach.

In closing, I would like to thank the Panel for the opportunity to present EquaTerra's knowledge and experiences. It is my hope that this has been a productive use or your time and that focusing attention on a lifecycle approach to sourcing, the power of relationship management and governance, and the value of independent and conflict-free advice and guidance aids the Panel in furthering acquisition thought-leadership among federal entities. At this time I would be happy to answer any questions the Panel may have. Thank you.

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2 Attachments:

Attachment 1 – Biography, Mark Stelzner

Attachment 2 – Blue Cross Blue Shield Rhode Island Article (CEO Magazine)